



Call Genie Inc.
Quarterly Report
September 30, 2004

Management's Discussion and Analysis

The following Management Discussion and Analysis ("MD&A") for Call Genie Inc. ("CG" or the "Company") should be read in conjunction with CG's 2004 unaudited interim period financial statements for the quarter ended September 30, 2004 and the accompanying notes and the audited annual financial and the accompanying notes for the year ended December 31, 2003 and the related annual MD&A. CG's unaudited interim period financial statements and the accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The information in this MD&A is current to November 17, 2004, unless otherwise noted.

FORWARD LOOKING STATEMENTS

Certain statements regarding CG contained herein may constitute forward-looking statements within the meaning of applicable securities laws. Forward-looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements of fact. Although CG believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. These statements are subject to certain risks and uncertainties and may be based on assumptions that could cause actual results to differ materially from those anticipated or implied in the forward-looking statements. CG's forward-looking statements are expressly qualified in their entirety by this cautionary statement.



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RESULTS OF OPERATIONS

Summary of Quarterly Results

	For the Quarters Ended							
	Dec 31 2002	Mar 31 2003	Jun 30 2003	Sep 30 2003	Dec 31 2003	Mar 31 2004	Jun 30 2004	Sep 30 2004
Expenses								
Technology and product development	\$ 9,991	\$ 37,000	\$ 37,476	\$ 61,371	\$ 143,683	\$ 164,453	\$ 177,907	\$ 196,418
Sales and marketing	-	-	-	-	-	-	-	26,921
Business development	-	-	-	-	-	-	-	12,191
General and administrative	47,422	24,293	120,516	110,591	325,872	199,937	155,713	187,174
Interest	-	-	-	64	5,867	13,191	10,460	-
Stock based compensation	-	-	-	-	55,593	56,457	56,456	155,490
Amortization	-	-	-	1,564	1,134	2,711	3,543	5,012
	<u>57,413</u>	<u>61,293</u>	<u>157,992</u>	<u>173,590</u>	<u>532,149</u>	<u>436,749</u>	<u>404,079</u>	<u>583,206</u>
Other income								
Interest income	-	-	-	-	-	-	-	4,409
Net loss for the period	<u>\$ (57,413)</u>	<u>\$ (61,293)</u>	<u>\$ (157,992)</u>	<u>\$ (173,590)</u>	<u>\$ (532,149)</u>	<u>\$ (436,749)</u>	<u>\$ (404,079)</u>	<u>\$ (578,797)</u>
Loss per share	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>	<u>\$ (0.03)</u>	<u>\$ (0.08)</u>	<u>\$ (0.06)</u>	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>

Expenses

The expenses for the three month period ended September 30, 2004 increased to \$583,206 from \$173,590 in the three month period ended September 30, 2003. The expenses for the nine month period ended September 30, 2004 increased to \$1,424,034 from \$392,875 in the nine month period ended September 30, 2003.

Technology and Product Development

Technology and product development costs increased by \$135,047 and \$402,931 for the three and nine month periods ended September 30, 2004, respectively, compared to the same periods of 2003.

The increases were primarily due to increased personnel engaged in developing the product software and processes, and readying and deploying the technology for two pilot programs. Personnel costs increased by \$114,783 and \$359,556 for the three and nine month periods



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ended September 30, 2004, respectively, compared to the same periods for 2003. Additional initial costs have also been incurred in setting up the voice platform with the local telephone provider and voice talent recording for the voice directory service. These costs increased by \$16,587 and \$27,805 for the three and nine month periods ended September 30, 2004, respectively, compared to the same periods of 2003.

Sales and Marketing

Sales costs of \$26,921 were incurred for both the three and nine month periods ended September 30, 2004 compared to \$nil for the same periods of 2003. The increase in costs were related to salaries and consulting fees paid to sales consultants to plan and perform a merchant sales test for the Greater Toronto Area (“GTA”).

Business Development

Business development costs of \$ 12,191 were incurred for both the three and nine months ended September 30, 2004 compared to \$nil for the same periods of 2003. The increases in costs were related to external costs for attending and presenting at a yellow page industry conference in the United States.

General and Administration

General and administration costs increased by \$289,015 and \$76,583 for the three and nine month periods ended September 30, 2004, respectively, compared to the same periods of 2003. The increases were primarily due to increased personnel engaged in financing, strategizing and leading the company into an operating phase. Personnel costs increased by \$14,026 and \$158,411 for the three and nine months ended September 30, 2004, respectively, compared to the same periods of 2003. Significant costs were also incurred in performing both consumer and merchant research. Research costs increased by \$19,400 and \$35,165 for the three and nine months ended September 30, 2004, respectively, compared to the same periods of 2003. Professional and agency fees associated with maintaining a public company caused increases over prior periods in the amount of \$33,269 for the nine month period and \$33,648 for the three month period ended September 30, 2004.

Office rent and travel expenses increased in relation to the additional personnel requirements and the additional travel to implement a pilot project in the Toronto market. Office rent and travel costs increased by \$9,294 and \$45,296 for the three and nine months ended September 30, 2004, respectively, compared to the same periods of 2003.



Interest

Interest expense of \$23,651 was incurred by CG on a convertible debenture for the nine months ended September 30, 2004 compared to \$1,655 for the nine months ended September 30, 2003. The debenture was converted into equity in May 2004.

Stock based compensation

Stock based compensation expense for the three month period ended September 30, 2004 was \$155,490, which was comprised of two amounts, namely (i) the write off of the balance of the stock based compensation related to the change in the vesting terms of warrants on the business combination and, (ii) for the stock based compensation related to the granting of options to employees effective September 1, 2004. The stock based compensation for the three month period ended September 30, 2003 was \$nil.

Stock based compensation expense for the nine months ended September 30, 2004 was \$268,403 compared to \$nil for the nine months ended September 30, 2003. The increase in the expense is related to warrants that were issued September 30, 2003 and the subsequent realization of the charge to income over the nine month period and the employee stock options described above.

Interest Income

CG earned interest income of \$4,409 on cash and term deposits, of which all was accrued, in the third quarter of 2004 compared to \$nil for the three months ended September 30, 2003. CG earned interest income of \$4,409 on cash and term deposits for the nine months ended September 30, 2004 compared to \$nil for the nine months ended September 30, 2003. The increase in interest income was as a result of having cash on hand from the closing of the business combination and concurrent financing in August, 2004.

Net Earnings

As a result of the foregoing, the net loss for CG for the third quarter of 2004 was \$578,797 which was \$405,207 higher than the same period in 2003, and the net loss for CG for the nine months ended September 30, 2004 was \$1,419,625 which was \$1,026,750 higher than the same period in 2003.



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Related Party Transactions

The Company had incurred rent charges from a corporation controlled by a shareholder resulting from the corporation's unwillingness to commit to a long term lease. Effective October 2004 the Company secured a sublease arrangement.

The operations of the Company were previously and partially funded by a convertible debenture from a corporate shareholder. These funds and the accrued interest were converted to equity during the May 2004.

Payments for technology and product development and general administrative work were paid to consultants who were shareholders of the Company. Effective September 1, 2004, the majority of these consultants were hired as full time employees. See also Note 7 to the unaudited interim period financial statements.

Critical Accounting Policies and Estimates

CGI prepares its consolidated financial statements in Canadian dollars and in accordance with accounting principles generally accepted in Canada.

There were no changes in accounting policies or significant estimates in the quarter other than the estimates used for stock based compensation. Since the Company is now publicly traded it now has a basis for evaluating the expected volatility rate. The Company has used a volatility rate of 55%.

FINANCIAL CONDITION

Outstanding Share Capital

CG's outstanding share capital is comprised of common shares. An unlimited number of common shares are authorized and 36,653,539 common shares were outstanding at September 30, 2004. Further information on the CG's outstanding share capital is provided in Note 8 to the unaudited interim period financial statements.

Business Combination

On August 17, 2004, the Company completed the business combination with GRD Enterprises Inc. ("GRD"), whereby GRD acquired all of the issued and outstanding shares of CG (and the warrants to purchase CG shares outstanding at closing). As consideration to the shareholders (and the warrant holders) of CG, GRD issued 24,709,139 common shares of its



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capital stock (and reserved for issuance 4,360,035 common shares) at a price of \$0.30 per share. The transaction received regulatory approval.

Legally, GRD would have been the parent of CG. However, as a result of the share exchange described above, control of the continuing entity was passed to the former shareholders of CG. This type of exchange is referred to as a “reverse take-over” in which CG was deemed the acquirer for accounting purposes.

Concurrent Financing

In conjunction with the business combination detailed above, GRD and CG entered into a financing engagement letter with First Associates Investments Inc. dated May 19, 2004 to sell 4,444,400 units of the Company on a best efforts basis. The offering closed on August 17, 2004, immediately after the above business combination, and raised gross proceeds of \$1,999,980 (net proceeds \$1,707,207) through the unit offering. Each unit was comprised of one common share in the capital of the Company and one-half of a share purchase warrant. Each full warrant entitled the holder to purchase one common share of CG at a price of \$0.90 per share for a period of 18 months from the closing date. The Agents received an option to acquire up to 10% of the units placed at the unit offering price, exercisable for a period of 18 months from the closing date.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows used in Operating Activities

For the third quarter ended September 30, 2004, the cash flows used in operating activities were \$929,716 compared to cash flows used in operating activities of \$153,853 for the third quarter ended September 30, 2003. For the nine month period ended September 30, 2004, cash flows used in operating activities were \$1,116,462 compared to \$383,780 for the same period in 2003. The increase in cash flows used in operating activities is primarily attributable to increased personnel and operating costs used to further the technology, test the product in two pilot projects, and generate consumer and merchant research for product development.

Cash flows used in Financing Activities

For the third quarter ended September 30, 2004, the cash flows from financing activities were \$1,770,971 compared to cash flows from financing activities of \$150,201 for the third quarter ended September 30, 2003. For the nine month period ended September 30, 2004, cash flows from financing activities were \$1,967,207 compared to \$416,474 for the same period in



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2003. The cash received from financing activities for 2004 was generated from the concurrent financing that raised net proceeds of \$1,707,207 and advances under convertible debentures.

Cash flows used in Investing Activities

For the third quarter ended September 30, 2004, the cash flows from investing activities were \$1,354,655 compared to cash flows used in investing activities of \$3,197 for the third quarter ended September 30, 2003. For the nine month period ended September 30, 2004, cash flows from investing activities were \$1,285,976 compared to cash flows used in investing activities \$10,397 for the same period in 2003. The cash received from investing activities for 2004 was received from the business combination with GRD (see Note 9 to the unaudited interim financial statements). Cash flows used for investing was primarily attributable to the computer equipment required for the software developers to develop the technology and the patents and trademark costs incurred to protect the technology.

As at September 30, 2004, CG had a positive working capital of \$2,097,960.

OUTLOOK

As outlined in the Filing Statement of GRD Enterprises Inc. (the predecessor of CG) dated June 22, 2004, CG had, by mid June, developed its Enhanced Voice Directory Service (the "EVD Service") technology to an operating Alpha version and was preparing the Beta version for a series of tests to, among other things, determine readiness for commercial launch. Under the long term, exclusive agreement with Yellow Pages Group Co. ("YPG") signed in December, 2003, two pilot projects were planned for Calgary and Toronto as precursors to the commercial launch of Call Genie's EVD Service in the Greater Toronto Area ("GTA"). These pilot projects were to utilize the Beta version of the application, with the primary objectives being to solicit feedback for system improvement and to collect voice utterances for tuning the voice recognition component.

Throughout June and July, 2004, CG conducted the Calgary pilot, which involved an end-to-end system operation and optimization test and an effort to gather user and merchant feedback. Users were sourced from CG contacts, as well as from contacts from professional advisors. Some two hundred users completed approximately two thousand information searches during the test. Approximately 100 surveys were completed by individuals who participated in the pilot, which indicated an average overall satisfaction with the EVD Service of seven out of ten, with approximately 70% of respondents indicating that they would use the service once per month or more frequently. As well, valuable written input and anecdotal comments were received. CG also conducted merchant focus groups where



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pricing assumptions and parameters were tested and merchants' intent to pay for the EVD Service was explored.

CG and YPG determined the Calgary pilot accomplished the goals established for the test and began a more extensive pilot in the GTA. The goal of the GTA pilot was to (i) expose the EVD Service to more rigorous use to allow the system to be fully tested and to provide voice utterances to enable further tuning, (ii) gather consumer feedback and intent to use, (iii) develop and test the sales message and material, and (iv) conduct sales tests with existing YPG advertisers to determine their willingness to subscribe for the EVD Service.

From August to November, 2004, CG and YPG conducted the GTA pilot. Consumer users of the EVD Service were sourced from the YellowPages.ca website and from Hotspex Inc., an independent consumer technology testing and surveying firm. From Hotspex, the consumer usability study resulted in approximately 800 users performing a minimum of seven information searches each. The survey showed 44% of the users rated the EVD Service eight or greater (out of ten) indicating a likelihood to use the EVD Service in the future. CG also received valuable feedback on how the service could be improved or the information presented or retrieved using alternate approaches. Overall, the usability study resulted in over 1,200 unique users generating approximately 10,000 information searches. This information allowed CG to improve the voice user interface and provided over 90,000 voice utterances. These utterances will be used to further tune the EVD Service, resulting in improvements in recognition rates and in grammar development. Another key finding, CG believes, is that the users' ability to quickly and efficiently retrieve the required information improved with each use as they became more familiar and formed a mental model of the EVD Service. It appears that by the third call, a user understands many of the capabilities of the service and how to more efficiently navigate it using voice input. CG is working to ensure the voice user interface provides the proper support to new users, while allowing experienced users to "barge" through for faster and more efficient access to information.

In October, 2004, CG and YPG conducted a sales test involving small and medium size businesses that advertise in YPG print and/or internet products in the GTA. The sales team consisted of former YPG sales personnel, together with members of CG's own sales team. The merchants were presented with a demonstration of the EVD Service to be offered by YPG together with a contract pricing schedule. The goal was to convince merchants to become early adopters of the service and to agree to a one year contract at a discounted price for the initial year.

The sales team presented the EVD Service to 103 YPG merchants over approximately four weeks. They closed or are finalizing contracts on 43 one year commitments, resulting in a 42% close rate. These merchants represented both smaller and higher value advertisers to YPG. The average net contract value was approximately \$750, representing a 56% discount to the full average annual price of approximately \$1,700. The merchants in the sales



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test also provided input on the usability of the system and on how to improve the utility of the service to their particular business.

As part of this sales test, an informal, basic price elasticity assessment was conducted with a subset of the merchants to help determine appropriate pricing parameters. No material resistance was encountered from such merchants utilizing higher contract values and lower discounts. YPG and CG are presently proposing that a discounted price be offered for the first year to encourage adoption by merchants; however the full scope of the pricing and service level options, together with the appropriate discounts, are still under discussion.

Additionally, the average commercial contract value will be influenced by the pricing and discount decision, as well as the relative mix of basic to high value advertisers. The GTA contains some 150,000 businesses, according to the Toronto Board of Trade, a material portion of which pay to advertise with YPG through print or internet directories. Businesses that do not pay YPG to advertise or are comparatively small advertisers (for instance, certain fast food establishments and financial institutions) are viewed by YPG and CG as a logical market for the EVD Service and a new opportunity for YPG.

Finally, a focus group was conducted with the sales personnel who sold the EVD Service during the sales test. They offered very positive comments about the EVD Service, noted that the service was straightforward to sell and concluded that it was complementary to other YPG print and internet offerings.

The EVD Service for the GTA covers some 500 category headings focused on business to consumer content. The location search capability for the EVD Service covers 379 neighborhoods, 206 landmarks and 3,299 intersections within the GTA. The database consists of over 80,000 businesses, representing over 170,000 listings. Improvements and upgrades to the EVD Service technology resulted from the information gathered through the two pilot projects, including four major system software releases.

Presently, both YPG and CG are continuing to review the results of the GTA pilot. Together, both companies are also evaluating the project economics, marketing, branding and advertising strategies, sales and pricing approaches, rollout scenarios, optimal and cost effective consumer access methods, billing and collection integration and resource allocation. Following review of the pilot project results and these other evaluations, YPG and CG will determine whether the EVD Service is ready for commercial launch in the GTA and, if so, the timing of that launch. Once YPG and CG determine to move ahead to commercial launch, CG intends to announce that milestone via press release.



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Assuming successful commercial launch and proof of concept in the GTA, it is anticipated that the EVD Service will be expanded through Southwest Ontario and into Montreal (collectively, a market roughly three quarters as large as the GTA), as well as possibly other urban centers in Ontario and Quebec, all under the exclusive agreement between YPG and CG.

The reader is directed to CG's website at www.callgenie.ca.